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EXONERATION CLAUSES IN WILLS AND TRUST INSTRUMENTS

*Robert Whitman**

I. INTRODUCTION

Exoneration clauses, also known as exculpatory or immunity clauses, in wills and trust instruments have been the subject of controversy for over two centuries. As early as 1785, the King's Bench in England noted that exoneration clauses were "common clause[s] of indemnity . . . tak[ing] away that responsibility which each [trustee] would be subject to . . . were it not for [the] clause"¹ Judicial acceptance and implementation of these clauses in the United States paralleled the industrial revolution and the advent of a

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1. *Bartlett v. Hodgson*, 99 Eng. Rep. 962, 962-63 (K.B. 1785). For other early cases recognizing exoneration clauses, see *Dawson v. Clarke*, 34 Eng. Rep. 311 (1810); *Pride v. Fooks*, 48 Eng. Rep. 1248 (M.R. 1839).

"freedom to contract" legal philosophy.² Today, exoneration clauses still widely appear in form books³ and are commonly drafted into wills, trusts, and other documents.⁴

It is not surprising, because of our system of state-by-state law-making, that these clauses are treated differently in various states. Often the differences in legislative and court approaches can be dramatic.⁵ In this article, the author questions whether such wide diversity remains appropriate or helpful. An analysis of the case law reveals that despite surface differences in the treatment of exoneration clauses, there is a widespread consensus with regard to their effectiveness. Also found is that often diverse legislative approaches actually may hamper courts from reaching equitable results. Because the results reached in cases arising throughout the U.S. are fairly consistent, the author recommends the creation of a uniform national rule to precisely define the scope of the effectiveness of exoneration clauses and suggests a blueprint for this change.

II. EXONERATION CLAUSES: PURPOSE AND FORM

Exoneration clauses are drafted into wills and trust instruments as a means of insulating the fiduciary from (1) the assertion of a claim against him by an interested party, and (2) from an ultimate finding of liability by a court for breach of fiduciary duty. One argument favoring liberal use of exoneration clauses suggests that, in the absence of such a clause, fiduciaries who fear suit are likely to be overly conservative in their investment and/or distribution policies. Another argument suggests that groundless suits should not be encouraged. Indeed, a client may purposely request the draftsman to include an exoneration clause in an instrument, in order to persuade a cautious person, or someone with limited experience, to undertake service as a fiduciary, or to induce that person to exercise broader and, hopefully, more beneficial discretion.

One argument in favor of restricting the effectiveness of an ex-

2. Cf. Horwitz, *The Rise of Legal Formalism* 19 AM. J. LEG. HIST. 251-53 (1975); see also W. FRIEDMANN, *Legal Theory* 140-43, 400-01 (1967) (discussing the theoretical development of individual rights).

3. See *Exculpatory Clauses - Their Legal Significance*, 1 REAL PROP., PROB. & TR. J. 530, 541 (1966) (appendix of which contains a large collection of exoneration clauses and cites numerous specific form books).

4. See generally A. SCOTT & W. FRATCHER, SCOTT ON TRUSTS §222 (1988) [hereinafter SCOTT]; G.G. BOGERT & G.T. BOGERT, THE LAW OF TRUSTS AND TRUSTEES §542 (1978) [hereinafter BOGERT].

5. See *infra* pp. 125-26.

onation clause points out that often a draftsman may include a clause without adequately explaining its impact to the client, or without even appraising her of its inclusion. The draftsman may in fact be closely allied with a corporate, or other, fiduciary who wants to be protected from liability through the inclusion of an exoneration clause. In a worst case scenario, the creator of the instrument will not even be aware of the fact that the clause has been included.

For purposes of this article, our concern is primarily with a clause which directly relieves the fiduciary of liability, such as when exculpation occurs by raising the level of culpability required in order to surcharge the fiduciary. An example of this type of clause would read: "No trustee shall ever be liable for any act of omission or commission unless such act is the result of gross negligence or of bad faith or of the trustee's own defalcation"⁶ Other similar clauses might speak of exemption from liability for ordinary negligence, mistakes, errors in judgment and gross negligence.⁷

A second, less direct method for limiting the liability of a fiduciary would be the use of a clause that expands the range of the fiduciary's acceptable actions.⁸ For example, a clause could expand investment alternatives to include the right of the fiduciary to invest in speculative securities.

III. OVERVIEW OF THE RANGE OF ACCEPTANCE OF EXONERATION CLAUSES

Either by state statute or case law, legislative and judicial attitudes towards permitting exoneration clauses have appeared to range from restrictive to liberal positions.⁹

A position referred to as restrictive is one which specifically prohibits the use of an exoneration clause. This view prevents the court from considering underlying facts in making a determination regard-

6. *Langford v. Shamburger*, 417 S.W.2d 438, 441 (Tex. Civ. App. 1967).

7. See *BOGERT*, *supra* note 4; see also *Corpus Christi Nat'l Bank v. Gerdes*, 551 S.W.2d 521 (Tex. Civ. App. 1977) (applying an exoneration clause that expressly included plain negligence, mistakes, and errors in judgment even where the trustee had been grossly negligent). It is conceivable that an exoneration clause might expressly exempt from liability a grossly negligent fiduciary, but this type of exoneration clause is less likely to be given full effect, especially in light of the recent trend towards moderate review within extreme states. See *infra* p. 149.

8. See *SCOTT*, *supra* note 4, § 222.1. Courts generally do not distinguish between methods of exoneration; rather, a court will focus on the scope and effect of the various exoneration clauses. For an example of actual testamentary language that employs the alternate method of exoneration, see *In re Will of Allister*, 144 Misc. 2d 994, 997, 545 N.Y.S.2d 483, 486 (Sur. Ct. 1989).

9. See *infra* pp. 126-146.

ing whether or not to enforce an exoneration clause. The most extreme regulation of exculpatory provisions in this manner has been by statute in New York.¹⁰

Section 222 of the Restatement of Trusts¹¹ is an example of a moderate approach where fiduciaries are permitted to be exculpated within pre-set bounds. Those pre-set bounds tend to draw the boundary for acceptable clauses at those clauses which allow for negligence by the fiduciary, but not gross negligence, recklessness, or intentional misconduct.¹² In jurisdictions following this moderate approach, exoneration clauses that attempt to exculpate fiduciary culpability greater than negligence are often invalidated by statute or court decision.¹³

States that have adopted the Uniform Trusts Act, Pennsylvania and Texas, are in sharp contrast since they have enacted a statutory approach which is liberal in its allowance of the use of exoneration clauses.¹⁴ In these jurisdictions, courts do not often invalidate exoneration clauses. Exoneration clauses in Texas have even been found to be protective of gross negligence by a corporate fiduciary,¹⁵ although, as will be seen below, this is not the norm.

After considering the outcomes of cases which have arisen in many jurisdictions, the author concludes that courts in jurisdictions governed by moderate statutes have the widest latitude to decide cases based upon the equities present in the actual fact patterns. These jurisdictions need not rationalize a proper decision in order to fit an overriding restrictive or liberal statutory pattern.

IV. COMPARISON OF THE RESTRICTIVE AND LIBERAL STATUTORY POSITIONS

A. *The Restrictive Position - New York*

New York, by statute, adopts a most restrictive approach to the use of an exoneration clause. New York State's Estates, Powers and Trusts Law, section 11-1.7, reads in part:

- (a) The attempted grant to an executor or testamentary trustee, or the successor of either, of any of the following enumerated powers or immunities is contrary to public policy:

10. See *infra* pp. 126-131.

11. RESTATEMENT (SECOND) OF TRUSTS §222 (1959) [hereinafter RESTATEMENT].

12. See RESTATEMENT §222 comments a, b.

13. See *infra* p. 149.

14. See *infra* pp. 131-34.

15. See *infra* pp. 140-41.

(1) The exoneration of such fiduciary from liability for failure to exercise reasonable care, diligence and prudence.

2) The power to make a binding and conclusive fixation of the value of any asset for purposes of distribution, allocation or otherwise.

(b) The attempted grant in any will of any power or immunity in contravention of the terms of this section shall be void but shall not be deemed to render such will invalid as a whole, and the remaining terms of the will shall, so far as possible, remain effective.

(c) Any person interested in an estate or trust fund may contest the validity of any purported grant of any power or immunity within the purview of this section without diminishing or affecting adversely his interest in the estate or trust, any provision in any will to the contrary notwithstanding.¹⁶

EPTL section 11-1.7 has been strictly construed by the New York courts. For example, in the case *In re Lang's Will*,¹⁷ the surrogate's court held that a paragraph in a will which prohibited the beneficiaries from questioning the trustee as to the management and administration of the testamentary trust violated EPTL section 11-1.7.¹⁸

New York courts have continued this strong enforcement of the statute. In two cases, *In re Allister*¹⁹ and *Estate of Lubin*,²⁰ the New York courts demonstrate a willingness to enforce the statutory provisions by not giving effect to exoneration clauses to the extent that they go beyond the limits allowed by the New York statute.

In *In re Allister*, Joan Krosner, the second successor trustee of a testamentary trust created by the decedent, sought judicial settlement of her account in the surrogate's court and moved for summary

16. N.Y. EST. POWERS & TRUSTS LAW §11-1.7 (McKinney 1967) [hereinafter EPTL].

17. 60 Misc. 2d 232, 302 N.Y.S.2d 954 (Sur. Ct. 1969).

18. The petitioners were beneficiaries of Lang's testamentary trust. Petitioners wanted both an accounting from the trustees and the right to generally question the trustee's management. Paragraph Eighth of the will was a forfeiture clause which specifically prohibited any interference with or questioning of the trustees. The will also prohibited bringing action for the partition of, or to question title to, any property held by the trust. The penalty for a beneficiary engaging in the prohibited conduct was loss of status as a beneficiary of the trust. The Court found that Paragraph Eighth, and paragraphs like it, were void under EPTL §11-1.7, stating: "As concerns the obvious attempt by the testator under Paragraph Eighth of the will to prohibit the beneficiaries of the testamentary trust from questioning the trustees as to the management and administration of the trust. . . [it] is clearly violative of public policy and applicable statutory law."

Id. at 233-34, 302 N.Y.S.2d at 955-56.

19. 144 Misc. 2d 994, 545 N.Y.S.2d 483 (Sur. Ct. 1989).

20. 143 Misc. 2d 121, 539 N.Y.S.2d 695 (Sur. Ct. 1989).

judgment on the issue of her liability.²¹ The decedent's son, H.M. Allister, was named as the beneficiary of the trust, but had recently died.²² Objections to the accounting were filed by the executor of H.M. Allister's estate. He claimed that Krosner breached her fiduciary duty by not making productive use of, and ultimately selling at a loss, the trust corpus: a piece of commercial property and stock in a realty corporation.²³

Krosner argued that the trust instrument exonerated her from liability for loss resulting from her retention of the property and stock. Article Six, Paragraph Two of the trust allowed the trustee to retain any property within the Estate "in his uncontrolled discretion. . . without liability for any decrease in value thereof. . . ."²⁴ Paragraph Three of Article Six allowed the trustee to invest "irrespective of whether the same may be authorized by the laws of the State of New York . . . and without any restrictions placed upon fiduciaries by any present or future applicable law, rule or court or court decision."²⁵ The surrogate's court, finding that both paragraphs violated EPTL section 11-1.7 and were offensive to public policy, denied Krosner's motion for summary judgment.²⁶

In *In re Lubin*, the attorney who drafted a will which nominated him as both the executor and trustee, petitioned to have the will submitted to probate in the Surrogate's Court, Bronx County.²⁷ The will contained an exoneration clause exculpating the executor from negligence, but not "fraud, misconduct, or gross negligence."²⁸ Perhaps on its own motion,²⁹ the court invalidated the exoneration clause. In dicta, the court stated that if this attorney had intentionally inserted an invalid exoneration clause into the testamentary trust instrument and had failed to inform the beneficiaries that this clause was a "toothless tiger",³⁰ the fiduciary's action would also be in violation of

21. *Allister*, at 995, 545 N.Y.S.2d at 484.

22. *Id.*

23. *Id.* at 996, 545 N.Y.S.2d at 485. The property was located in Freeport, N.Y.. It was rented for the first eight months of 1974, then remained vacant until it was sold in 1984 at a loss of \$2,643.17. The stock was sold in 1982, eight years after its distribution into the trust, at a loss of over \$7,800. *Id.*, 545 N.Y.S.2d at 485.

24. *Id.* at 997, 545 N.Y.S.2d at 486.

25. *Id.*, 545 N.Y.S.2d at 486.

26. *Id.* at 998, 545 N.Y.S.2d at 486-87.

27. *Lubin*, at 121-22, 539 N.Y.S.2d at 696.

28. *Id.* at 122, 539 N.Y.S.2d at 696.

29. In the opinion, it is unclear whether an opposing party filed objections to the petition to admit the will to probate or whether the court refused to admit the will on its own motion.

30. *Lubin*, at 122, 539 N.Y.S.2d at 696.

the Code of Professional Responsibility.³¹ However, since this particular attorney was inexperienced in the area of trusts, his actions were found to be unintentional and, therefore, not unethical.³² Moreover, the court deemed the will valid but the exoneration clause void as against public policy.³³

While consistently upholding EPTL section 11-1.7 in the context of exoneration clauses in wills or testamentary trusts, the New York courts have, in contrast, read the statute narrowly as applying only to "an executor or testamentary trustee."³⁴ For example, the Surrogate's Court in *In re Sherman's Estate*³⁵ held that EPTL section 11-1.7 did not apply to a trustee of an inter vivos trust.³⁶ In *Sherman*, the executor of Sherman's estate petitioned for a judicial settlement of the account. Sherman's widow filed objections.³⁷ Sherman and his brother were both shareholders in a closed corporation through which they did business.³⁸ Before his death, Sherman entered into an agreement with his brother which gave one of them, upon the other's death, the option to purchase the deceased brother's stock.³⁹ The agreement included clauses exonerating the executor of Sherman's estate from liability for failure to enforce the agreement and gave the executor broad discretion in deciding whether or not to enforce that agreement. Sherman's will and codicil mentioned the agreement between the brothers and reiterated the exoneration clauses.⁴⁰

The widow argued that EPTL section 11-1.7 voided the exoneration clauses and that the clauses were contrary to public policy and, therefore, the entire agreement between Sherman and his brother was void.⁴¹ In finding for the executor, the Surrogate's Court held that both the agreement and the exoneration clauses were valid.⁴² The court characterized the agreement between the brothers as a separate inter vivos contract whose mention in the will did not affect

31. MODEL CODE OF PROFESSIONAL RESPONSIBILITY, DR 7-102 (1989).

32. *Lubin*, at 122, 539 N.Y.S.2d at 697.

33. *Id.*, 539 N.Y.S.2d at 697.

34. EPTL §11-1.7.

35. 141 N.Y.S.2d 789 (Sur. Ct. 1955).

36. *Id.* at 792.

37. *Id.* at 791.

38. *Id.*

39. *Id.*

40. *Id.*

41. *Id.*

42. *Id.* at 792.

the executor's duty.⁴³

Similarly, in the case *O'Hayer v. De St. Aubin*,⁴⁴ the New York Appellate Division validated the language of the powers provisions of an inter vivos trust which permitted extensive self-dealing on the rationale that EPTL section 11-1.7 has no application to a living trust.⁴⁵

In one frequently cited New York decision, *In re Cowles' Will*,⁴⁶ the New York Appellate Division even cited Restatement section 222⁴⁷ as the proper standard for reviewing exoneration clauses in inter vivos trusts.⁴⁸

43. *Id.*

44. 30 A.D.2d 419, 293 N.Y.S.2d 147 (App. Div. 1968).

45. In *O'Hayer*, Ovide de St. Aubin, Sr. created an inter vivos trust, naming himself and his son, Ovide, Jr., as trustees and beneficiaries, and his daughter, Lorraine O'Hayer, as a beneficiary. Two corporations comprised the corpus of the trust. The trust was to be terminated upon the death of both Ovide, Sr. and Ovide, Jr. The trust instrument declared that it was the strong intent of the settlor that both he and Ovide, Jr. profit from the trust. *Id.* at 421, 293 N.Y.S.2d at 149.

The daughter, Lorraine O'Hayer, appellant and original plaintiff, brought suit against the executors of Ovide, Jr.'s estate requesting that the estate be surcharged for various breaches of trust committed by Ovide, Jr. At issue were various self-dealings by Ovide, Jr., including buying from the trust just enough stock to become a majority stockholder over his sister, taking loans from the trust funds which caused the trust to borrow at higher interest rates, and arranging a contract between his own personal corporation, Tahoma Mills, Inc., and L&L, a subsidiary of Vesta, so that Vesta paid Tahoma large sums of money. The court did not allow the latter two dealings, demanded an accounting of the loans made to Ovide, Jr. from the trust corpus, and surcharged Ovide, Jr. all of the assets from Tahoma Mills. However, the court upheld Ovide, Jr.'s purchase of Vesta Corporation and Vesta Underwear stock from the trust corpus. The court explained that it was the blatant and specific intention of Ovide, Sr., as evidenced by the language of the trust instrument, that Ovide, Jr. be able to purchase the stock and that this language properly exonerated Ovide, Jr. from liability for what would have otherwise been a breach of the duty not to self-deal. *Id.* at 423-24, 293 N.Y.S.2d at 151-52.

46. 22 A.D.2d 365, 255 N.Y.S.2d 160 (App. Div. 1965).

47. RESTATEMENT §222 represents the moderate position regarding the court enforcement of exoneration clauses. See *infra* p. 146.

48. The trusts in question were two inter vivos trusts created by a married couple. The trust created by Louise Cowles named her husband, Russel, as the primary life beneficiary. Russel Cowles' trust named Louise as the primary life beneficiary. The Bank of New York was named trustee for both trusts and this proceeding was initiated by the bank in order to obtain a judicial settlement of its accounts. Objections were filed by two beneficiaries of the trusts, Elizabeth Cowles Harris and Marcia Cowles Platt, granddaughters of Louise and Russel Cowles. *Id.* at 367-68, 255 N.Y.S.2d at 163-65.

The objections to the bank's administration of the trust revolved around investments made by the bank which resulted in a total loss. Between 1917 and 1921, the bank purchased stock in the Ansonia Clock Company at the request of Russel Cowles. The stock began to decline in 1928, and the bank then sold the Ansonia stock and purchased Tork Clocks, Inc. stock. *Id.* at 374-75, 255 N.Y.S.2d at 170-71.

The court found that the stock purchase was a prudent investment because Russel Cowles had suggested and approved of the purchase, and because Cowles was the vice president of the

Perhaps the unwillingness of the New York courts to expand upon the literal language of the statute reflects a simple exercise in judicial restraint.⁴⁹ However, it should be noted that there is a definite absence of legislative response to these cases. Given the expanding practice of using living trusts for lifetime and estate planning purposes,⁵⁰ can the courts' decisions, taken together with the legislature's failure to act, be read as a clear change in attitude from the original legislative conviction in New York that exculpatory clauses need to be strongly curtailed?

B. *The Liberal Statutory Position - The Uniform Trusts Act, Pennsylvania, and Texas*

1. Overview

As compared to New York, the states in which the Uniform Trusts Act⁵¹ is now in force, Pennsylvania and Texas, fall at the other end of the spectrum of attitudes concerning exoneration clauses. All of these states have promulgated a very liberal, non-restrictive statutory regulation of exoneration clauses; however, some courts in these jurisdictions have interpreted these liberal statutes restrictively.⁵²

The Uniform Trusts Act was first adopted by the Conference of Commissioners on Uniform State Laws and the American Bar Association in 1937.⁵³ Official comments to the Act indicate that its creation was first suggested by the American Bankers Association and guided by advice given by the Trust Division of the Bankers Association.⁵⁴ Given the extensive involvement of the Bankers Association,

company. Further, the court gave effect to the exoneration clauses in the trust instruments, citing Restatement §222 and stating: "In light of the facts as they appear in the record and were heretofore discussed, there is no basis for a finding of willful negligence, self-dealing or bad faith on the part of the trustee in any of the questioned transactions."

Id. at 378, 255 N.Y.S.2d at 174.

49. *Cf. Clymer v. Mayo*, 393 Mass. 754, 473 N.E.2d 1084 (1985) (statute revoking will disposition on divorce was extended by the court to cover revocation of disposition in power over trust.); C. ANTIEAU, *ADJUDICATING CONSTITUTIONAL ISSUES* §10.22 (1985) (describing deference to Congress given by U.S. Supreme Court); *see also* R. JOHNSTON, *THE EFFECT OF JUDICIAL REVIEW ON FEDERAL-STATE RELATIONS IN AUSTRALIA, CANADA, AND THE UNITED STATES* 47-97 (1969).

50. *See* Langbein, *The Nonprobate Revolution and the Future of the Law of Succession*, 97 HARV. L. REV. 1108 (1984).

51. UNIF. TRUSTS ACT, 7B U.L.A. 763 (1937) [hereinafter ACT].

52. *See infra* pp. 136-38 & 142-45.

53. ACT, 7B U.L.A. 763 (1937).

54. *See id.* at 763.

an organization which represents corporate fiduciaries, it should not be surprising that the drafters of the Act endorsed a relaxed approach towards regulation of exoneration clauses. The pertinent section of the Act reads:

The settlor of any trust affected by this Act may . . . relieve his trustee from any or all of the duties, restrictions, and liabilities which would otherwise be imposed upon him by this Act . . . but no act of the settlor shall relieve a trustee from the duties, restrictions, and liabilities imposed upon him by sections 3 [loaning of trust funds to self or affiliate], 4 [corporate trustees depositing trust funds with self], and 5 [trustee buying from or selling to self] of this Act.⁵⁵

Presently, only six states and one territory are governed wholly, or in part, by the Act:⁵⁶ Louisiana,⁵⁷ Nevada,⁵⁸ New Mexico,⁵⁹ North Carolina,⁶⁰ Oklahoma,⁶¹ South Dakota,⁶² and the Virgin Islands.⁶³ In the jurisdictions which have the Act, section 17 has been adopted almost verbatim, with a few interesting exceptions.⁶⁴

55. ACT, §17, 7B U.L.A. 787-88 (1937).

56. The foregoing list appears in the official comments to the Uniform Trusts Act. See ACT, 7B U.L.A. at 763.

57. LA. REV. STAT. ANN. §§ 9:1725, 9:2062-63, 9:2065, 9:2084-86, 9:2112, 9:2114, 9:2122, 9:2124-26, 9:2196, 9:2207-08 (West 1991). The statute pertaining to exoneration clauses is LA. REV. STAT. ANN. § 9:2206 (West 1991) and no longer follows the Uniform Trusts Act. Section 9:2206 repealed LA. REV. STAT. ANN. § 2035 (West Appendix 1991), which did follow the Uniform Trusts Act model.

58. NEV. REV. STAT. §§ 163.010 - 163.210 (Michie 1986). The statute pertaining to exoneration clauses is NEV. REV. STAT. § 163.160 (Michie 1986).

59. N.M. STAT. ANN. §§ 46-2-1 - 19 (Michie 1989). The statute pertaining to exoneration clauses is N.M. STAT. ANN. §46-2-14 (Michie 1989).

60. N.C. GEN. STAT. §§ 36A-60 - 84 (1991). The statute pertaining to exoneration clauses is N.C. GEN. STAT. § 36A-78 (1984).

61. OKLA. STAT. ANN. tit. 60, §§ 175.1 - .23 (West 1971). The statute pertaining to exoneration clauses is OKLA. STAT. ANN. tit. 60, § 175.21 (West 1971).

62. S.D. CODIFIED LAWS ANN. §§ 55-4-1 - 55-4-36 (1990). The statute pertaining to exoneration clauses is S.D. CODIFIED LAWS ANN. § 55-4-30 (1988).

63. V.I. CODE ANN. tit. 15, §§ 1091 - 1111 (1967). The statute pertaining to exoneration clauses is V.I. CODE ANN. tit. 15, §1107 (1967).

64. North Carolina omits the language "his trustee from any or all duties, restrictions, and . . ." from its statute, so that the language in the North Carolina statute reads: "The settlor . . . may . . . relieve liabilities which would otherwise be imposed upon [the trustee] by this Act." N.C. GEN. STAT. § 36A-78 (1984). The effect, if any, of this change is unclear because the statute has not been construed in reported case law.

Oklahoma restricts its prohibition of exoneration for self-dealing only to corporate trustees. See OKLA. STAT. ANN. tit. 60, § 175.21 (West 1991). This is one of the few instances where, by statute, the legislature held corporate trustees to a higher standard of conduct than individual trustees in spite of the fact that commentators have been suggesting the use of a

Pennsylvania has not adopted the Uniform Trusts Act, but has had a liberal exoneration statute since 1949. The pertinent section reads, in part:

The testator or settlor in the instrument establishing a trust may prescribe the powers, duties, and liabilities of the fiduciary regarding the investment or noninvestment of principle and income and the acquisition . . . and disposition of . . . any property which . . . shall come into his control; and whenever any such provision shall conflict with this chapter, such provision shall control not withstanding this chapter. . . .⁶⁵

Despite the seemingly limitless power given to the settlor of a trust to exculpate his or her trustee, the Pennsylvania courts have consistently imposed restrictions on the effect of exoneration clauses, bringing Pennsylvania, by case law, to a moderate position.⁶⁶

The most recent enactment of a liberal statute regulating exoneration clauses occurred in Texas in 1983. In 1943, Texas had adopted the Uniform Trusts Act as part of the Texas Trust Act.⁶⁷ At that time, section 17 of the Uniform Trusts Act was adopted almost verbatim, except that in the Texas statute, corporate trustees would not be exculpated for self-dealing although individual trustees were not subject to the same restriction.⁶⁸ In 1983, the Texas legislature repealed the Trust Act, but passed a sweeping statute that gives the creator of the instrument as much freedom to exonerate the fiduciary as the creator had under the old Texas Trust Act.⁶⁹ The new statute, Texas Property Code section 113.059, reads:

(a) Except as provided by subsection (b) of this section, the settlor by provision in an instrument creating, modifying, amending, or revoking the trust may relieve the trustee from a duty, liability, or restriction imposed by this subtitle.

(b) A settlor may not relieve a corporate trustee from the duties,

higher standard for corporate fiduciaries since the 1930's. See *infra* pp. 159-162 for a more thorough discussion; see also TEX. PROP. CODE ANN. § 113.059 (West 1991) (also holding corporate fiduciaries to a higher standard of conduct).

Louisiana, in its enactment, kept most of the Uniform Trusts Act but repealed its statute coinciding with § 17 of the Act. See LA. REV. STAT. ANN. § 2035 (West 1991). Louisiana now takes a more moderate statutory approach to the policing of exoneration clauses. See LA. REV. STAT. ANN. § 2206 (West 1991); *infra* notes 201-234 and accompanying text.

65. PA. CONS. STAT. ANN. § 7319(a) (Purdon 1975).

66. See *infra* notes 92-115 and accompanying text.

67. TEX. REV. CIV. STAT. ANN. art. 7425b-1-47 (Vernon 1960).

68. TEX. REV. CIV. STAT. ANN. art. 7425b-22 (Vernon 1960) (repealed 1984).

69. TEX. PROP. CODE ANN. § 113.059 (Vernon 1984).

restrictions, or liabilities of Section 113.052 or 113.053 of this act.⁷⁰

2. Analysis of Case Law Under the Uniform Trusts Act

Even though the statutes based on the Uniform Trusts Act were enacted decades ago, very few reported cases have construed them. However, from the few cases that have been reported it appears that the courts in jurisdictions which follow the Act give deference to the original legislative intent of the framers of the Act. In general, the reported cases reflect the courts' unwillingness to intrude and possibly curb trustees acting under the safeguard of an exoneration clause, so long as it appears to the court that the trustee was attempting in good faith to properly carry out the fiduciary function. In particular, where close family relationships are involved, the courts adopt a policy of not policing family matters unless fraud or bad faith is shown.⁷¹

For example, in *Newman v. Morris*,⁷² the Oklahoma Supreme Court sustained a demurrer, thereby exonerating a trustee from alleged liability based, in part, on the fact that the trustee was the wife of the beneficiary and appeared to be acting in good faith. Phyllisjean Newman was the trustee of a revocable trust created by herself and her then husband, Warren Morris.⁷³ The corpus of the trust was comprised of three lots of land, A, B and C, situated in northwest Oklahoma City.⁷⁴ Faced with an unproductive corpus and a possible default of the first mortgage for all three lots, Newman and Morris negotiated a deal with Downing & Jackson, an unaffiliated corporation, wherein Downing & Jackson refinanced the mortgage of all three lots and financed construction of a gas station on lot C.⁷⁵ In return, Newman, as trustee, unconditionally conveyed lots B and C to Downing & Jackson to use as collateral until Downing & Jackson recouped their investment plus an additional agreed-upon return.⁷⁶ Years later, after Newman and Morris had divorced, Morris sued Downing & Jackson for reconveyance and sued Newman charging

70. *Id.* Sections 113.052 and 113.053, respectively, deal with the loaning of trust funds to a trustee and the purchase or sale of trust property by a trustee.

71. *See, e.g., Newman v. Morris, infra* notes 72-81 and accompanying text; *see also Bank of Nevada v. Speirs, infra* notes 82-91 and accompanying text.

72. 574 P.2d 615 (Okla. 1977).

73. *Id.* at 615.

74. *Id.* at 615-16.

75. *Id.* at 616.

76. *Id.*

breach of fiduciary duty for failure to compel Downing & Jackson to reconvey.⁷⁷ The original revocable trust was terminated by written instructions of Newman and Morris, as trustees; in those instructions, the preceding acts of Newman, as trustee, were ratified and exoneration was given to Newman from all liability arising out of any of Newman's acts as trustee.⁷⁸ The trial court failed to reach the question of the exoneration clause and sustained Newman's demurrer, because it found that there was no property in the trust that Newman could have reconveyed.⁷⁹

On appeal, the Oklahoma Supreme Court sustained Newman's demurrer and held that even if there was property to reconvey and Newman had breached her fiduciary duty, the exoneration clause was valid and absolved Newman from all liability.⁸⁰ The court noted that there did not appear to be any fraud or abuse of the fiduciary relationship on the part of Newman, suggesting that, had the facts been otherwise, the court might have been willing to invalidate the exoneration clause.⁸¹

In *Bank of Nevada v. Speirs*,⁸² the Supreme Court of Nevada upheld an exoneration clause in a trust instrument based, in part, on the court's policy not to police family matters in the absence of fraud or bad faith. Karen Speirs was the beneficiary of a testamentary trust created by her mother, Lena Coulthard.⁸³ Lena Coulthard owned stock in the Silvagni Estate Co., which owned the Horseshoe Building in Las Vegas and some real estate.⁸⁴ Lena bequeathed half of her stock and land to her husband, G. William Coulthard, and the other half to G. William Coulthard, in trust for their daughter Karen.⁸⁵ The trust instrument did not contain a classic exoneration clause, but did contain a clause allowing G. William Coulthard, as trustee, complete discretion in investing the trust corpus.⁸⁶

Coulthard purchased five Iowa farms for the trust which, prior to the termination of the trust, were sold at a substantially higher

77. *Id.*

78. *Id.* at 617.

79. *Id.* at 616.

80. *Id.* at 617.

81. *Id.* at 617.

82. 95 Nev. 870, 603 P.2d 1074 (1979), *cert. denied*, 449 U.S. 994 (1980).

83. *Id.* at 872, 603 P.2d at 1075.

84. *Id.*, 603 P.2d at 1075.

85. *Id.*, 603 P.2d at 1075.

86. *Id.*, 603 P.2d at 1075.

price.⁸⁷ Coulthard also purchased additional interests in the Horseshoe Properties for himself but not for the trust.⁸⁸ Karen Speirs sued the Bank of Nevada as executor of G. William Coulthard's estate, charging Coulthard with breach of fiduciary duty for purchasing the Iowa farms and for failing to purchase additional Horseshoe stock for the trust while purchasing the stock for himself. The district court agreed with Karen Speirs, finding that Coulthard had acted improperly as trustee.⁸⁹

On appeal, the Nevada Supreme Court reversed, finding G. William Coulthard neither negligent in his investments nor self-dealing in his personal purchase of additional Horseshoe stock.⁹⁰ The court deferred to the broad discretion given the trustee by the trust instrument, stating:

This broad grant of authority, this testamentary exoneration of the trustee for mistakes, if any, must be accorded respect by a court. This would seem especially true in a family setting where it is apparent that the wife-mother wanted the husband-father to have absolute control of the trust established for the benefit and care of their daughter, knowing that he would act with love and care.⁹¹

The underlying assumption on the part of the courts in the two cases above appears to have been that the creators had good reason to want to exonerate their trustees; they had faith in the trustees and assumed that the trustees would be honest in their administration of the trusts.

3. Analysis of Case Law Under the Pennsylvania Statute

Despite a very non-restrictive Pennsylvania statute,⁹² the Pennsylvania courts have consistently and uniformly placed moderate controls over the effectiveness of exoneration clauses. As early as 1938 the Pennsylvania Supreme Court used the standard established by the Restatement section 222,⁹³ which represents a moderate position with regard to the control by the courts of exoneration clauses.⁹⁴

87. *Id.* at 873, 603 P.2d at 1076.

88. *Id.* at 872-73, 603 P.2d at 1075-76.

89. *Id.* at 873, 603 P.2d at 1076. For a description of the trial court's holding, see *Bank of Nevada*, 95 Nev. at 870, 603 P.2d at 1074.

90. *Id.* at 873-74, 603 P.2d at 1076-77.

91. *Id.* at 873, 603 P.2d at 1076.

92. See PA. CONS. STAT. ANN. tit. 20, § 7319 (1975).

93. See, e.g., *Gouley v. Land Title Bank & Trust Co.*, 329 Pa. 465, 198 A. 7 (1938).

94. See *infra* notes 185-192 and accompanying text.

Whereas the liberal position taken by the Pennsylvania statute would suggest that there should be little or no court regulation over the use of an exoneration clause, the moderate position, reflected by the Restatement, would guide a court towards not permitting the use of an exoneration clause to shield a fiduciary who was guilty of gross negligence or intentional misconduct.

In *Gouley v. Land Title Bank & Trust Co.*,⁹⁵ plaintiff Gouley was a class "A" bondholder and, representing herself and other bondholders, sued the Land Title Bank & Trust as trustees.⁹⁶ Land Title Bank & Trust administered a piece of commercial property placed in one of their trusts and sought to secure a corporate mortgage on the property through the issuance of bonds.⁹⁷ Gouley brought suit to surcharge the trustees for losses sustained by the bondholders allegedly caused by breaches of trust.⁹⁸ The mortgage for the commercial property was to be repaid from 1923 to 1933.⁹⁹ The mortgage payments had ceased in 1925.¹⁰⁰ Gouley bought her bond in 1929 with no notification that the mortgage had been in default for four years.¹⁰¹ Gouley argued that the failure to notify her of the mortgage prior to her purchase of the bond constituted a concealment of the default and a willful breach of fiduciary duty.¹⁰² Defendant trustees argued that the security company was the sole agent for the bondholders, that the security company was notified of the default, and that Gouley's failure to be notified was the security company's fault.¹⁰³

The Supreme Court of Pennsylvania upheld the trial court's decision in favor of the trustees.¹⁰⁴ The court found that the mortgage instrument did not require the trustees to notify the bondholders directly, unless the bondholders requested such a notification, which they did not.¹⁰⁵ The court also approved of an exculpatory clause in the mortgage document which protected the trustees from any liability except for willful and intentional breaches of trust.¹⁰⁶ In the

95. 329 Pa. 465, 198 A. 7 (1938).

96. *Id.* at 467, 198 A. at 8.

97. *Id.*, 198 A. at 8.

98. *Id.* at 468, 198 A. at 8.

99. *Id.* at 467, 198 A. at 8.

100. *Id.* at 468, 198 A. at 8.

101. *Id.*, 198 A. at 8.

102. *Id.*, 198 A. at 8.

103. *Id.*, 198 A. at 8.

104. *Id.* at 471, 198 A. at 9.

105. *Id.* at 469, 198 A. at 8.

106. *Id.* at 471, 198 A. at 9.

course of the opinion, the court twice cited to the Restatement¹⁰⁷ and called it a "well-settled principle."¹⁰⁸

Notwithstanding the subsequent adoption in Pennsylvania of a very unrestrictive statute,¹⁰⁹ the Supreme Court of Pennsylvania has continued to follow antecedent caselaw by applying the Restatement position in its examinations of exoneration provisions. This can be clearly seen in the 1980 case, *In re Niessen*.¹¹⁰

In *Niessen*, beneficiaries of a testamentary trust were appealing an affirmation of the First Account by the Orphan's Court Division of the Montgomery Court of Common Pleas.¹¹¹ The beneficiaries charged one of the co-executors, Fidelity Bank, with breach of trust for merely maintaining custody of various securities in the trust portfolio, instead of selling them to obtain a higher profit.¹¹² The trust instrument contained a clause exonerating the trustees for, "any mistake or error of judgment made in good faith."¹¹³

The Pennsylvania Supreme Court reaffirmed the Orphan's Court's findings that the trustees had not acted in bad faith and found that the exoneration clause was effective in protecting the trustees from liability.¹¹⁴ The court held that the exoneration clause in the will was controlling and provided for a lower standard of care than would normally be applied to will or trust instruments.¹¹⁵

4. Analysis of Case Law Under the Texas Statute

Texas courts, which originally applied the Uniform Trusts Act,¹¹⁶ and now apply the new Texas exoneration statute,¹¹⁷ have been given a greater opportunity to examine the defenses based upon the liberal exoneration statutes. However, the Texas courts have not adopted a uniform approach in construing the statute. Some courts

107. *Id.* at 470-71, 198 A. at 9.

108. *Id.* at 471, 198 A. at 9.

109. PA. STAT. ANN. tit. 20, § 7319 (Purdon 1975).

110. 489 Pa. 135, 413 A.2d 1050 (1980).

111. *Id.* at 137, 413 A.2d at 1051-52.

112. *Id.* at 138, 413 A.2d at 1052.

113. *Id.* at 140, 413 A.2d at 1053.

114. *Id.* at 141, 413 A.2d at 1054.

115. See *id.* at 139, 413 A.2d at 1052. It is interesting to note that in both of the above decisions, in spite of the fact that the court applied the more rigorous Restatement position rather than the more liberal position taken by the Pennsylvania statute, the result was in favor of the fiduciary.

116. TEX. REV. CIV. STAT. ANN. art. 7425b-22 (Vernon 1960).

117. TEX. PROP. CODE ANN. § 113.059 (Vernon 1984).

in Texas have upheld the non-restrictive use of exoneration clauses¹¹⁸ while others have followed the approach seen in Pennsylvania,¹¹⁹ moving Texas, by case law, to a position that is more moderate than the Texas statute suggests.¹²⁰

*Burnett v. First National Bank of Waco*¹²¹ is an example of a case in which a Texas court has strictly adhered to the liberal exoneration provisions of section 113.059 and its predecessor. In *Burnett*, the Court of Civil Appeals of Texas, Eastland, upheld a directed verdict in favor of exoneration of a trustee bank that loaned trust money to companies owned by the creator, and also beneficiary, of the trust.¹²² The C&G Trust, the trust at issue, was a revocable trust created by Clarence Burnett and his wife, Gladys.¹²³ The First National Bank of Waco served as trustee and Clarence and Gladys were the life beneficiaries of the trust.¹²⁴ First National Bank brought suit against Clarence Burnett, claiming Burnett guaranteed loans made by the C&G trust, which were in default, and for which the bank was seeking repayment from Burnett individually.¹²⁵ Burnett counter-sued arguing that the bank breached its duty as trustee by "fail[ing] to perform its discretionary functions as trustee because it did not exercise its own judgment before making the loans."¹²⁶

The loans were made to three companies, all of which were partially owned by Burnett.¹²⁷ Burnett served as an executive officer for two of those companies.¹²⁸ Loans were also made to two of Burnett's close business associates.¹²⁹ The trust instrument gave the bank trustee complete discretion in the investment and distribution of the trust funds.¹³⁰ Burnett was always fully informed of the loans and he

118. See *infra* notes 121-146 and accompanying text.

119. See *infra* notes 147-184 and accompanying text.

120. Perhaps the willingness of Texas courts to deviate from the liberal statutory presumption in favor of upholding exoneration clauses may account for the wealth of litigation over the effectiveness of exoneration clauses in Texas. This is more clearly seen when compared to the dearth of litigation emanating from jurisdictions in which courts are not willing to deviate from the liberal exoneration provisions of the Uniform Trusts Act.

121. 567 S.W.2d 873 (Tex. Civ. App. 1978).

122. *Id.* at 874.

123. *Id.*

124. *Id.*

125. *Id.* at 875.

126. *Id.* at 874.

127. *Id.*

128. *Id.*

129. *Id.*

130. *Id.*

approved of them in writing.¹³¹

The Texas Court of Appeals rejected Burnett's argument that the bank breached its duty.¹³² It held that Burnett had ratified the loans made by the bank and, therefore, coupled with the broad discretion given to the bank originally, the bank should be exonerated from liability for allowing those loans.¹³³ The court also found that the bank did not engage in the self-dealing prohibited by section 113.059, so Burnett's ratification was valid under the statute.¹³⁴

A line of Texas cases following *Burnett* demonstrate that some Texas courts will not deviate from the liberal Texas statute. Even in a situation where gross negligence existed, such as in the often cited case *Corpus Christi National Bank v. Gerdes*,¹³⁵ the Court of Civil Appeals of Texas, Corpus Christi, enforced a broad clause exonerating the trustee from liability. Specifically, the court held that the trustee should be exonerated from liability "for any mistake or error of judgment or negligence, but [held the trustee] liable only for her or its own dishonesty."¹³⁶ The trust in question was a testamentary trust created by Casper Gerdes, Jr.¹³⁷ After Gerdes' death, discord arose between the Corpus Christi National Bank, as trustee, and the beneficiaries of the trust: Casper's wife, Clyde Gerdes, and their daughter, Sally Gerdes.¹³⁸ Corpus Christi National Bank petitioned the court for its removal as trustee, increased compensation, and attorney's fees.¹³⁹ Mr. and Mrs. Gerdes counter-sued, claiming that Corpus Christi National Bank was negligent and grossly negligent in its handling of the trust's real property in Texas and Louisiana and in partitioning the estate's assets.¹⁴⁰ The trial court allowed the bank to resign, but granted Mrs. Gerdes recovery for the bank's negligence and gross negligence.¹⁴¹ The jury had awarded Mrs. Gerdes over \$9,000 in damages, but the court reduced that award to \$750 on remittitur.¹⁴² Both parties appealed.

The Texas Court of Civil Appeals overruled the trial court on

131. See *Burnett*, 536 S.W.2d at 603-06.

132. *Id.* at 606.

133. *Id.* at 876.

134. *Id.*

135. 551 S.W.2d 521 (Tex. Civ. App. 1977).

136. *Id.* at 523.

137. *Id.* at 522.

138. *Id.* at 523.

139. *Id.*

140. *Id.* at 523.

141. *Id.*

142. See *id.* at 522-23 for a description of the trial outcome.

the issue of Mrs. Gerdes' recovery. The Appellate Court found that the exculpatory provision in Mr. Gerdes' will was valid, stating: "It is clear . . . that the public policy prohibition is limited to exculpatory clauses which authorize self-dealing, which is not in our case."¹⁴³ Further, the court held that Mrs. Gerdes was prevented from recovering for the bank's gross negligence.¹⁴⁴

A still more recent case reiterates the Corpus Christi court's position and also shows the courts' tendency to uphold a liberal exoneration clause where the creator of the instrument attempts to exonerate persons who are close to him. In 1987, in *Blieden v. Greenspan*,¹⁴⁵ the Court of Appeals of Texas, Beaumont, upheld the broad statutory allowance of exculpation of trustees permitted by section 113.059 where the co-trustees, who were closely related to the settlor, commingled funds and the beneficiaries sought to surcharge the last surviving trustee for the commingling.¹⁴⁶

143. *Corpus Christi*, 551 S.W.2d at 524.

144. *Id.*

145. 742 S.W.2d 93 (Tex. Civ. App. 1987), *rev'd*, 751 S.W.2d 858 (Tex. 1988). Hyman Blieden created two testamentary trusts for the benefit of his wife, Doris. Some of Doris and Hyman's community property was placed in the trusts. Doris and Hyman's brother, William Blieden, was nominated co-trustee of both trusts. Hyman Blieden's will specifically indicated that his primary concern was the care of his wife and not the preservation of the trust corpus. To accomplish this, Blieden's will gave Doris Blieden the right to commingle trust funds with her own personal property. 742 S.W.2d at 94.

Appellants in this case were the beneficiaries of one of Blieden's trusts, the Blieden, Wolff, and Tennenbaum Trust, and brought suit for recovery for appellee Greenspan's misadministration of the trusts. Appellee in this case, Arthur Greenspan, was nominated successor trustee after the deaths of William and Doris Blieden. Greenspan argued that he never accepted the trustee position and that the exoneration clauses in Hyman Blieden's will protected him from liability. *Id.* at 96.

The trial court granted summary judgment in favor of appellee Greenspan, finding that Greenspan had not accepted the trustee position. The court also found that, even if Greenspan had accepted the position as trustee, he would have been protected by the exoneration clauses in Blieden's will. The court stated: "It is well settled that the public policy prohibition is limited to exculpatory provisions which actually authorize self-dealing. There is no self-dealing shown in the case subjudice." *Id.* at 97.

The Texas Supreme Court reversed on the grounds that Greenspan may have accepted the trustee position and that summary judgment was not proper because of this fact in controversy. This opinion did not discuss the alternate holding that Greenspan was exonerated by the clause in Blieden's will. The court remanded and, on remand in an opinionless decision, the trial court did not award anything to Blieden's beneficiaries. *See Blieden v. Greenspan*, No. C-7201 (June 1, 1988).

146. In an interesting portion of the opinion, the court reviewed the history of § 113.059, noting that corporate trustees are held to a higher standard than individual trustees. The court also approvingly noted that the Texas legislature, though repealing most of the old Texas Trust Act, maintained a liberal statute regarding exoneration clauses, stating: "[T]his codification makes it clear that the legislature's intention has been, and is, to continue the broad grant of

In contrast to *Burnett*,¹⁴⁷ *Corpus Christi*¹⁴⁸ and *Blieden*,¹⁴⁹ other Texas courts have been willing to consider placing limits on the scope of section 113.059. The often cited case of *Langford v. Shamburger*¹⁵⁰ can be viewed as a clear deviation from other Texas courts' strict application of section 113.059.

In *Langford*, decided by the Court of Civil Appeals of Texas, Fort Worth, P.P. Langford III, as a beneficiary, sued C.D. Shamburger, individually and as trustee of the P.P. Langford III Trust.¹⁵¹ Langford claimed that Shamburger had borrowed money from the trust fund, commingled trust money with his own and failed to invest large amounts of trust funds.¹⁵² In its original holding¹⁵³ and in its rehearing opinion,¹⁵⁴ the court was careful to limit itself to invalidating only exoneration language that permitted self-dealing. However, the court expanded the restrictive language of section 113.059 by holding that the individual trustee, not just the corporate trustee, could also be found liable under the statute for self-dealing despite the inclusion of an exoneration clause in the trust instrument or will.¹⁵⁵

What is striking about the opinion is the concern expressed by the court concerning the need for the court to control the misbehavior of trustees. Three pages of the opinion,¹⁵⁶ and a good portion of the rehearing opinion,¹⁵⁷ are devoted to a discussion of the need for proper court controls over trustees. The court cited the landmark New York case of *Meinhard v. Salmon*,¹⁵⁸ which advocated strong

authority and power given a trustor or settlor to establish a trust and exculpate the trustee as the trustor or settlor desired." See *Blieden*, 742 S.W.2d at 96-97.

147. See *supra* notes 121-134 and accompanying text.

148. See *supra* notes 135-144 and accompanying text.

149. See *supra* notes 145 and accompanying text.

150. 417 S.W.2d 438 (Tex. Civ. App. 1967).

151. *Id.* at 440.

152. *Id.*

153. *Langford*, 417 S.W.2d at 438.

154. *Id.* at 446.

155. *Id.* at 447.

156. *Id.* at 443-46.

157. *Id.* at 446-47.

158. 164 N.E. 545 (1928). The famous quotation by Judge Cardozo from *Meinhard* used by the Texas Court of Civil Appeals is as follows:

Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undi-

control over trustees and suggested that control over a trustee might be appropriate even when the beneficiaries have knowledge of a trustee's breach of duty and fail to complain.¹⁵⁹ A dissenting opinion on the rehearing¹⁶⁰ advocated following prior Texas precedent which endorsed the adherence to the Texas liberal statutory position.

In *Interfirst Bank Dallas N.A. v. Risser*,¹⁶¹ the Court of Appeals of Texas, Texarkana, took an even larger step in monitoring the conduct of trustees under section 113.059. In *Interfirst Bank*, the appellees, and original plaintiffs, were beneficiaries of two testamentary trusts created by Dr. Joe Risser, Sr.¹⁶² Appellant, Interfirst Bank Dallas, served as trustee for both trusts.¹⁶³ The beneficiaries commenced suit against Interfirst Bank claiming that the bank breached its duty of loyalty through self-dealing.¹⁶⁴ The Bank argued, among other things,¹⁶⁵ that the exoneration clause in Joe Risser, Sr.'s will exculpated them from any liability. The clause permitted exoneration of the bank for any act or failure to act absent proof of bad faith.¹⁶⁶

Among the assets of the two trusts were over nine hundred shares of stock in the Southwest Pump Company.¹⁶⁷ The beneficiaries alleged that Interfirst Bank, acting as trustee, sold the stock back to Southwest Pump Company below the fair market price.¹⁶⁸ Southwest Pump Company, in turn, sold the stock to Sally Estes, president of the Southwest Pump Company, giving Estes absolute voting control over Southwest Pump.¹⁶⁹

The trial court found that Interfirst Bank had breached its fiduciary duty by self-dealing, and allowed a jury verdict of over

vided loyalty by the 'disintegrating erosion' of particular exceptions. . . . Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court. (citation omitted).

Id. at 546.

159. *Langford*, 417 S.W.2d at 445.

160. *Id.* at 447.

161. 739 S.W.2d 882 (Tex. App. 1987).

162. *Id.* at 886.

163. *Id.* at 887.

164. *Id.*

165. The bank also argued that their actions did not constitute self-dealing, that the stock was sold at fair market value, that the jury instructions contained errors, and that the exemplary damages were too high and should not have been awarded at all. *Id.* at 888.

166. *Interfirst Bank*, 739 S.W.2d at 888.

167. *Id.* at 887.

168. *Id.*

169. *See id.* at 887.

\$1,000,000 in actual damages and \$10,000,000 in punitive damages.¹⁷⁰ The Court of Civil Appeals sustained the trial court's judgment finding that Interfirst was guilty of self-dealing; however, the court limited the amount of punitive damages to \$2,678,750.¹⁷¹

The Court of Civil Appeals defined self-dealing broadly as, "[a]ny type of activity by the trustee which gives the trustee an advantage to the detriment of the beneficiaries. . . ."¹⁷² Since Interfirst had been self-dealing, the court did not allow protection of Interfirst under the exoneration clause in Risser's will. Of particular interest is the fact that the court further limited the scope of protection under the exoneration clause by citing the moderate Restatement standard as the proper interpretation of section 113.059:

Neither can an exculpatory provision in the trust instrument be effective to relieve the trustee of liability for action taken in bad faith or for acting intentionally adverse or with reckless indifference to the interests of the beneficiary. Restatement (Second) of Trusts section § (1959).¹⁷³

The court's application of the moderate Restatement standard represents a sharp change in direction from the approach in *Burnett, Corpus Christi* and *Blieden*.¹⁷⁴

Interfirst Bank Dallas v. Risser has been approvingly cited in more recent Texas cases. In *Grider v. Boston Co., Inc.*,¹⁷⁵ a group of limited partners brought suit against the general partners of The Boston Company, Inc., claiming that the general partners had charged them excessive administration fees.¹⁷⁶ Each limited partnership agreement gave the general partners broad discretion in their management.¹⁷⁷ The agreements also included clauses exonerating the company for liability, "except for willful [sic] malfeasance or fraud."¹⁷⁸ The court cited *Risser*, stating:

When the parties bargain on equal terms, a fiduciary may contract for the limitation of his liability. *Cf. Risser*, 739 S.W.2d at 888. However, public policy precludes the limitation of liability for (1)

170. *See id.* at 909-10.

171. *Id.* at 909.

172. *Id.* at 898.

173. *Id.* at 888.

174. *See supra* notes 122, 136, 146 and accompanying text.

175. 773 S.W.2d 338 (Tex. Ct. App. 1989).

176. *Id.* at 339.

177. *Id.*

178. *Id.*

self-dealing, (2) bad faith, (3) intentional adverse acts, and (4) reckless indifference with respect to the beneficiary and his best interest. *Id.* at 897-98. *See also* Tex. Prop. Code Ann. § 113.059.¹⁷⁹

Although the Texas Court of Appeals found that the plaintiffs had failed to plead any of the public policy prohibitions cited in *Risser* and the Restatement, (therefore, the exoneration clause protected the general partners), the priority of the *Risser* approach was implicitly accepted.

Texas courts have not moved uniformly towards a moderate position regarding the policing of exoneration clauses; however, a fair reading of the Texas case law aligns Texas courts with the general approach courts are taking to the enforcement of exoneration clauses across the country.¹⁸⁰ For the most part, Texas courts will act decisively to prevent wrongdoing resulting from bad faith and/or over-reaching. Though apparently inconsistent in their approach to the Texas statute, both *Blieden*¹⁸¹ and *Interfirst Bank*¹⁸² can be largely reconciled with each other and the general national trend by looking beyond the courts' reasoning to the underlying facts presented in the cases. In *Blieden*, where bad faith or abuse of the fiduciary relationship was not shown, the court, without question, permitted the exoneration clause to protect the trustee.¹⁸³ In *Risser*, bad faith and severe self-dealing was shown so that, in spite of the literal statutory language, the court did not permit the exoneration clause to be effective.¹⁸⁴

The consistent pattern apparent in Texas cases is that Texas courts will control trustees when they see an egregious wrong; however, they will allow an exoneration clause to take effect when the claimed wrong does not appear to be egregious and the creator of the instrument intentionally protected the fiduciary by including an exoneration clause.

179. *Id.* at 343.

180. *See, e.g., infra* pp. 149-154.

181. 742 S.W.2d 93 (Tex. Ct. App. 1987), *rev'd*, 751 S.W.2d 858 (Tex. 1988). For a discussion of the case, see *supra* note 145.

182. 739 S.W.2d 882 (Tex. Ct. App. 1987). For a discussion of the case, see *supra* notes 161-173 and accompanying text.

183. *See supra* note 146.

184. *See supra* pp. 143-44.

V. STATES THAT HAVE ADOPTED MODERATE POSITIONS BY STATUTE OR CASE LAW

A. *Moderate Statutes*

1. States That Have Adopted Restatement-Type Statutes

Section 222 of the Restatement (Second) of Trusts,¹⁸⁵ adopted in 1959, reflects a common moderate approach, both for states which have adopted statutes and for states relying solely on case law. Section 222 reads:

(1) Except as stated in Subsections (2) and (3), the trustee, by provisions in the terms of the trust, can be relieved of liability for breach of trust.

(2) A provision in the trust instrument is not effective to relieve the trustee of liability for breach of trust committed in bad faith or intentionally or with reckless indifference to the interest of the beneficiary, or of liability for any profit which the trustee has derived from a breach of trust.

(3) To the extent to which a provision relieving the trustee of liability for breaches of trust is inserted in the trust instrument as the result of an abuse by the trustee of a fiduciary or confidential relationship to the settlor, such provision is ineffective.¹⁸⁶

185. RESTATEMENT (SECOND) OF TRUSTS § 222 (1959). Section 222 was not revised in the Second Restatement and has remained the same since the first Restatement of Trusts. See RESTATEMENT OF TRUSTS § 222 (1935).

186. The official comment to subsection (1) of section 222 provides that all exculpatory provisions are to be strictly construed and that the trustee will be exonerated only if its acts fall within the explicit language of the provision. See RESTATEMENT (SECOND) OF TRUSTS § 222 comment (a) (1959).

The official comment to subsection (2) distinguishes classic exoneration clauses, in which the standard of fiduciary care is to be lowered, from indirect methods of exoneration resulting from clauses limiting a trustee's obligations by broadening or limiting its duties. The comment provides:

If by the terms of the trust it is provided that the trustee shall not be under any duty to do or to refrain from doing an act . . . the trustee does not commit a breach of trust in doing or failing to do the act, unless such a provision is ineffective as contrary to public policy.

See RESTATEMENT (SECOND) OF TRUSTS § 222 comment (c) (1959).

The official comment to subsection (3) indicates that the following factors are considered in deciding whether there has been an "abuse of a fiduciary relationship": (a) is there a less-than-arm's length relationship between the settlor and the fiduciary?; (b) was the instrument drafted by the fiduciary or someone allied with the fiduciary?; (c) was the settlor experienced or inexperienced with business affairs, and, further, does the settlor have an understanding of the exculpatory provision?; (d) was the provision inserted due to a trustee's undue influence or other improper conduct?; and, (e) how reasonable is the provision itself? See RESTATEMENT (SECOND) OF TRUSTS § 222 comment (d) (1959).

Five states currently have statutes based upon the Restatement: California, Georgia, Indiana, Louisiana, and Montana. All of the statutes have been fairly recently enacted. Louisiana's statute,¹⁸⁷ the oldest, was enacted in 1964; section 30-4-3-31¹⁸⁸ of the Indiana Code was enacted in 1984; section 16461¹⁸⁹ of the California Probate Code was enacted in 1986; section 72-34-512¹⁹⁰ of the Montana Trust Code was enacted in 1989; and, section 53-12-194¹⁹¹ of the Georgia Code was enacted in 1991. In each of the five states that have enacted statutes based on the Restatement, the changes to section 222 have been only slight.¹⁹²

2. Statutorily Moderate Positions Other Than the Restatement

Two states, Connecticut¹⁹³ and Washington,¹⁹⁴ have moved by statute towards moderate positions without adopting section 222 of the Restatement. Although these moderate statutes are drafted independently from the Restatement model, the flexible language employed and the standards for public policy limitations used resemble the standards set in the Restatement.

187. LA. REV. STAT. ANN. § 9:2206 (West 1991).

188. IND. CODE § 30-4-3-31 (1991).

189. CAL. PROB. CODE ANN. § 16461 (West 1991). In 1986, the California legislature first enacted section 16461. During the 1990 legislative session, California repealed its 1986 Probate Code but preserved section 16461 without change.

190. MONT. CODE ANN. § 72-34-512 (1989). Official comments to section 72-34-512 indicate that the Montana legislature used California's statute as a model but removed "bad faith" from subsection 2(a) because it felt that such language was too subjective.

191. GA. CODE ANN. § 53-12-194 (1991). Prior to the enactment of section 53-12-194, the Supreme Court of Georgia cited section 222 of the Restatement. See *Perling v. Citizens and Southern Nat. Bank*, 300 S.E.2d 649 (Ga. 1983). However, the Court in *Perling* only approves of comment (a) of the Restatement section 222 which indicates that exoneration clauses are to be strictly construed. The court then exonerates Citizens and Southern National Bank from liability for failure to diversify the trust corpus and for retaining stock that was becoming less valuable over a period of years. Official comments to section 53-12-194 cite to *Perling*. Perhaps the Georgia legislature enacted section 53-12-194 to prevent the broad, hands-off judicial policy towards trustees that the Georgia Supreme Court took in *Perling*. The official comments do not clarify why *Perling* was cited.

192. The general public policy prohibitions of subsection two were embodied in all five state enactments, but in several states some of the specific terms were omitted and some new terms were added. For example, the California legislature added "gross negligence" to its list of public policy restrictions adopted from section 222. Compare CAL. PROB. CODE § 16461 (West 1991) with RESTATEMENT (SECOND) OF TRUSTS, § 222 (1959).

Three states, California, Montana, and Georgia, have entirely omitted subsection (3) from their statutes.

193. See CONN. GEN. STAT. § 45a-234 (38) (1990).

194. See WASH. REV. CODE § 11.97.010 (1987).

The history of the development of a statutory scheme for regulating the use of exoneration clauses in Washington demonstrates the move, both by case law and statute, towards a moderate position. Washington originally had a liberal statute¹⁹⁵ containing language that appears to be taken from section 17 of the Uniform Trusts Act,¹⁹⁶ where no public policy restrictions were placed on exoneration clauses - not even a restriction on self-dealing. In 1984, the Washington legislature recodified and amended section 30.99.020 by adding a final sentence onto the statute. The statute, renumbered section 11.97.010, now includes: "In no event may a trustee be relieved of the duty to act in good faith and with honest judgment."¹⁹⁷ This language marks a definitive change towards a moderate approach for Washington, bringing Washington's statute in line with the growing number of moderate jurisdictions.

Connecticut is unusual in that its statute was not drafted as a statute; rather, Connecticut's moderate approach was incorporated into a subsection of a much broader statute, The Fiduciary Powers Act.¹⁹⁸ Subsection 38 of the Connecticut Fiduciary Powers Act reads:

The fiduciary is hereby exonerated from any liability resulting from its retention, sale or operation, whether due to losses, depreciation in value or actions taken or omitted to be taken with respect to any business, farm or real estate interests held in an estate or trust, nor shall the fiduciary be liable for any loss to or depreciation of any other estate or trust property, so long as it is acting in good faith in the management thereof and exercising reasonable care and diligence, but the fiduciary is not exonerated from his own bad faith, willful misconduct or gross negligence.¹⁹⁹

It should be noted that the Connecticut Legislature's choice of placement for their exoneration statute appears exceptional and inappropriate. A look at the index to the Connecticut General Statutes reveals that the exoneration subsection is difficult, if not impossible, to find; the index contains no reference to exoneration or related

195. WASH. REV. CODE ANN. § 30.99.020 (1959). For a description of the text, see the historical note to WASH. REV. CODE ANN. § 11.97.010 (West 1987).

196. See *supra* note 55 and accompanying text.

197. WASH. REV. CODE ANN. § 11.97.010 (West 1987).

198. CONN. GEN. STAT. § 45a-234 (1990).

199. *Id.* at § 45a-234 (38). The Fiduciary Powers Act was first enacted in 1969 and was amended in 1971. The original draft appears to be limited to exoneration for mismanagement of a business, farm or real estate; however, the 1971 amendment broadened the subsection by allowing exoneration for any property held in an estate or trust. *Id.* (historical notes).

subjects.

B. *An Analysis of Case Law Under Moderate Statutes*

As suggested above with regard to the law in Texas and Pennsylvania,²⁰⁰ exoneration case law throughout moderate jurisdictions can be largely reconciled by an analysis which suggests that honest, if slightly negligent, fiduciaries will be exonerated by courts where instruments contain sufficiently broad exoneration clauses; further, fiduciaries who act with a greater degree of culpability than ordinary negligence will not be protected by the courts from liability regardless of the existence of an exoneration clause in the governing instrument. The Texas and Pennsylvania courts, in spite of the existence of seemingly conflicting statutory authority, developed this standard by court decision. As will be seen immediately below, courts in the moderate statutory jurisdictions, aided by the existence of consistent statutory authority, are able to arrive at reasonable results based on the actual fact pattern without the need to struggle with an inflexible overriding statute.

In *Maginnis v. Maginnis*,²⁰¹ the Court of Appeals of Louisiana permitted an exoneration clause to protect a fiduciary from liability for a mistake in accounting that was not caused by the fiduciary.²⁰² In *Maginnis*, the beneficiary of a testamentary trust, Gordon Maginnis, brought suit against his brother, John Maginnis, seeking removal of his brother as trustee and repayment of interest on sums that John Maginnis allegedly withheld from the trust corpus.²⁰³

The Maginnis' mother, Ruth Maginnis, had created three testamentary trusts, including the trust for Gordon Maginnis.²⁰⁴ The trust instrument contained an exoneration clause relieving the trustees of all liabilities resulting from breach of trust.²⁰⁵ An accounting made in preparation for the initial distribution of the estate into the trusts revealed that a little over \$16,700 of Gordon Maginnis' trust money was given to John Maginnis by mistake.²⁰⁶ The accounting was prepared by an attorney and CPA mutually chosen by Gordon and John Maginnis.²⁰⁷ The Court of Appeal of Louisiana found that

200. See *supra* pp. 136-145.

201. 449 So. 2d 573 (La. Ct. App. 1984).

202. *Id.* at 575.

203. *Id.* at 574.

204. *Id.*

205. *Id.*

206. *Id.*

207. *Id.*

the error did not occur "through any fraud, bad faith, or breach of the duty of loyalty on the part of John. . . ." ²⁰⁸ In analyzing the effect of the exoneration clause, the court stated:

The trust instrument relieved the trustees . . . of all liability for breach of trust except breach of the duty of loyalty. The Trust Code permits the trust instrument to exculpate a trustee from all liability for breach of trust except in breach of trust committed in bad faith, or one committed in breach of the duty of loyalty. . . . Thus, the exculpatory provision of the trust instrument is fully enforceable. ²⁰⁹

Since the court found that John Maginnis had neither breached his duty of loyalty, nor acted in bad faith, nor was willfully fraudulent, the court found the exoneration clause fully effective in protecting him. ²¹⁰

In contrast, in *In re Donald Bradford Trust*, neither the Louisiana Court of Appeal ²¹¹ nor the Louisiana Supreme Court ²¹² allowed an exoneration clause to fully protect a trustee whose actions were characterized by the courts as willful and grossly negligent.

The trust in question was created by Donald Bradford for the benefit of his three children, Mark Allen, Leigh Ann, and Amy Crowell. ²¹³ Donald Bradford, an attorney at the time of the creation of the trust, nominated one of the attorneys in his law firm, Ben R. Downing, Jr., as trustee. ²¹⁴ Downing later filed a petition to resign and, by ex parte order, was allowed to resign without rendering a final accounting of the trust. ²¹⁵ Downing was succeeded by E. Briggs Wharton, a friend of the family. ²¹⁶

The trust instrument contained a clause exonerating the trustee from liability for every act, even those of others, except for the trustee's own willful fault or gross negligence. ²¹⁷

Donald Bradford had been receiving distributions from the trust

208. *Id.* at 575.

209. *Id.* at 574-75.

210. *Id.* at 575.

211. 524 So. 2d 1213 (La. Ct. App. 1987), writ granted, 526 So. 2d 785 (La. 1988).

212. 538 So. 2d 263 (La. 1989).

213. *Bradford Trust*, 538 So. 2d at 264. At first, the trust corpus contained slightly over forty shares of stock in a local corporation. The trust was later supplemented by Bradford's father-in-law, who donated \$54,000 to the trust. 524 So. 2d at 1214.

214. 538 So. 2d at 264.

215. 524 So. 2d at 1214-15.

216. *Id.*

217. 524 So. 2d at 1214.

fund during both Downing and Wharton's trusteeships.²¹⁸ For example, over \$15,000 had been given to Bradford in the form of dividends from a partnership interest which he had previously sold to the trust.²¹⁹ Further, over \$16,000 had been distributed to Bradford from the trust for purposes such as making an unsecured personal loan to Bradford's brother and for family vacations.²²⁰ Moreover, in what was perhaps the most flagrant act of abuse, Wharton, as sole trustee, sold from the trust corpus thousands of shares of stock in the Lehman Company.²²¹ Bradford personally borrowed the revenue from the sale and in return, gave the trust an unsecured non-interest bearing promissory note for the loan.²²² Although Bradford repaid the promissory note, he did not pay any interest on the money until after the commencement of the lawsuit, and then repaid only seven percent interest.²²³

Mark Allen and Mrs. Anne Crowell Wilson, tutrix²²⁴ of her minor daughter, Amy Crowell, brought suit against Wharton, charging him with breach of trust for disbursing money to Bradford and for failing to demand a final accounting from Downing which would have revealed Downing's disbursements to Bradford.²²⁵ The plaintiffs also requested that Wharton be forced to resign and surcharged for revenues and profits due to his breach of trust.²²⁶

Wharton responded that he was not liable for the acts of Downing because the court had issued an *ex parte* order which allowed Downing to resign without rendering an accounting of the trust.²²⁷ He also argued that even if the court found that the order was invalid and a breach of trust was committed, such breach did not result from any willful fault or gross negligence on his part; therefore, the exoneration clause in the trust protected him from liability.²²⁸

The Court of Appeal of Louisiana found Wharton liable for his breach of duty and for Downing's breach of duty.²²⁹ Specifically, the court found that Wharton committed both a willful breach of trust

218. *Id.* at 1216.

219. *Id.*

220. *Id.* at 1216-17.

221. *Id.* at 1217.

222. *Id.*

223. *Id.*

224. A tutor/tutrix is the closest civil law equivalent to a common-law guardian.

225. 524 So. 2d at 1214-15.

226. *Id.* at 1214.

227. *Id.* at 1214-15.

228. *Id.* at 1218.

229. *Id.* at 1218-19.

and a breach of the duty of loyalty by joining with Downing to obtain Downing's resignation without an accounting and allowing Bradford to use the trust funds.²³⁰ Due to the culpability of Wharton's actions, the court found that the exoneration clause in the trust instrument was ineffective in protecting him.²³¹

The Supreme Court of Louisiana affirmed the appellate court's judgment against Wharton for the breach of trust committed during his trusteeship.²³² However, the court reversed the appellate court's judgment against Wharton for Downing's breach of trust, stating:

When the foregoing provisions of the [Louisiana Trust Code²³³] and the trust instrument are considered together, it is apparent that Wharton could only be liable for losses resulting from his (1) gross negligence; (2) willful fault (bad faith) or (3) breach of duty of loyalty to a fiduciary . . . Given the existence of a judicial order relieving Downing of the duty to file a final account, Wharton's failure to disregard the order and demand an accounting did not constitute gross negligence, willful misconduct, or a breach of any duty to the fiduciaries.²³⁴

As the case illustrates, the language of section 9:2206 and the language of section 222 of the Restatement are flexible. A moderate statute gives the court wide latitude in deciding a matter since the court, as finder of fact, can exercise its discretion in characterizing the questionable conduct. For example, in *Bradford*, the Louisiana Court of Appeal found Wharton's failure both grossly negligent and willful, whereas the supreme court characterized Wharton's failure to demand an accounting as less than grossly negligent or willful. The flexibility of section 9:2206 allowed both Louisiana courts to make conflicting judgments regarding the culpability of the trustee while still remaining within the prevailing statutory provision.

Similarly, the Connecticut statute²³⁵ has been effective in allowing the Connecticut courts to concentrate on the culpability of

230. *Id.*

231. *Id.* at 1218. The court held that "[t]he duty of loyalty is the fundamental duty owed by a trustee as a fiduciary. Because of that fact, [the] exculpatory provision in the trust instrument [was] not effective to relieve the trustee from liability. . . ." *Id.*

232. 538 So. 2d 263, 267-68.

233. LA. REV. STAT. ANN. tit. 9, § 2206(b) (West 1991). The pertinent section of this statute provides that an exoneration clause "is not effective to relieve the trustee from liability for breach of the duty of loyalty to a beneficiary or for breach of trust committed in bad faith." *Id.*

234. *Bradford Trust*, 538 So. 2d at 267.

235. CONN. GEN. STAT. tit. 45A, § 234(38) (1990).

the fiduciary based on the actual facts. In *Jackson v. Conland*,²³⁶ the Connecticut Supreme Court upheld an exoneration clause where the trustees of an inter vivos trust were found neither to have committed any willful misconduct, nor to have acted with reckless disregard for the interests of the beneficiaries.²³⁷ The trust was created by John Day Jackson, owner of the New Haven Register newspapers.²³⁸ The trust corpus, in part, contained all but two shares of the Register Corporation.²³⁹ The trustees at the time of the event at issue were two family members, Lionel S. Jackson, son of John Day, and Lionel S. Jackson, Jr., grandson of John Day.²⁴⁰ A third trustee, not a family member, was Henry J. Conland.²⁴¹

The plaintiff beneficiaries brought suit charging the trustees with breach of trust for willful failure to observe the prudent investor standard and for reckless disregard to the interests of the beneficiaries.²⁴² After studying the investment and obtaining a vote of approval from the board of directors of the Register Corporation, the trustees purchased the Hartford Times newspaper.²⁴³ The Times had been losing money, but the trustees had speculated that the Times could again be a profitable newspaper if it combined forces with the Register.²⁴⁴ The Times failed to improve and the trustees made advances to the Times in order to try to sell it to recoup some losses.²⁴⁵

First, the trustees argued that the trust instrument did not require them, as trustees, to observe the prudent investment standard.²⁴⁶ The trust instrument provided that "in exercising their discretion with respect to this matter, they shall not be held to the standard of a prudent investor. . . ."²⁴⁷

Second, the trustees argued that even if they were required to observe the prudent investor standard, and therefore breached their duty as trustees by purchasing the Times, the breach was not willful or reckless, and thus the exoneration clause in the trust instrument

236. 178 Conn. 52, 420 A.2d 898 (1979).

237. *Id.* at 52, 420 A.2d at 898.

238. *Id.* at 53, 420 A.2d at 899.

239. *Id.*, 420 A.2d at 899.

240. *Id.* at 54, 420 A.2d at 900.

241. *Id.*, 420 A.2d at 900.

242. *Id.*, 420 A.2d at 900.

243. *Id.* at 59, 420 A.2d at 902.

244. *Id.*, 420 A.2d at 902.

245. *Id.* at 60, 420 A.2d at 902.

246. *Id.* at 54, 420 A.2d at 900.

247. *Id.* at 56, 420 A.2d at 901. "This matter" refers to the retaining or selling of trust assets and general administration of the trust. *Id.*, 420 A.2d at 901.

protected them from liability for the Times purchase.²⁴⁸ The exoneration clause provided that "no trustee shall be held liable to any beneficiary . . . for any act or omission to act as such trustee . . . unless such act or omission to act constituted willful misconduct on his part."²⁴⁹

The trial court agreed with the trustees, finding that the trustees were not required to strictly observe the prudent investor standard by the trust instrument and therefore had not breached their fiduciary duty by purchasing the Times.²⁵⁰ The trial court also found that the trustees had not acted with reckless disregard for the beneficiaries and that there had been no willful misconduct on the part of the trustees.²⁵¹ The Connecticut Supreme Court upheld both findings of the trial court.²⁵²

C. *Moderate Case Law in the Absence of a Statute*

1. Analysis of Case Law in Restatement Jurisdictions

In addition to providing a basis for a growing number of moderate state statutes regulating exoneration clauses, Restatement section 222 is also the standard cited by many state courts in states that do not have a statute regulating the use of exoneration clauses. Approximately thirty-four states do not have statutes regulating exoneration clauses. Of the approximately twenty-four states whose courts have ruled on the effectiveness of exoneration clauses without statutory guidance, some thirteen of the states in this group have cited the Restatement section 222 as the proper standard.²⁵³ Even in the absence of any guiding statute, the basic analysis, mentioned above,²⁵⁴ applies. In these Restatement common law jurisdictions, fiduciaries

248. *Id.* at 57, 420 A.2d at 901.

249. *Id.*, 420 A.2d at 901.

250. *Id.* at 54, 420 A.2d at 900.

251. *Id.* at 57, 420 A.2d at 901.

252. *Id.* at 60, 420 A.2d at 902.

253. These jurisdictions include: Delaware, *see* *Riggs Nat'l Bank v. Zimmer*, 1977 WL 5316 (Del. Ch. 1977); the District of Columbia, *see* *Godette v. Cox*, 592 A.2d 1028, 1033 (D.C. Cir. 1991); Illinois, *see* *Axelrod v. Giambalvo*, 129 Ill. App. 512, 517, 472 N.E.2d 840, 844 (1984); Iowa, *see* *Hanson v. Minette*, 46 N.W.2d 592, 597 (Iowa 1990); Maryland, *see* *Attorney Grievance Comm'n v. Owrutsky*, 322 Md. 334, 350, 587 A.2d 511, 518 (1991); Massachusetts, *see* *Boston Safe Deposit & Trust Co. v. Boone*, 21 Mass. App. Ct. 637, 489 N.E.2d 209 (1986); Missouri, *see* *Jarvis v. Boatmen's Nat'l Bank*, 478 S.W.2d 266, 274 (Mo. 1972); New Jersey, *see* *Farr v. First Camden Nat'l Bank & Trust Co.*, 4 N.J. Super. 89, 94, 66 A.2d 444, 446 (App. Div. 1949); Tennessee, *see* *Petty v. Privette*, 818 S.W.2d 743, 747 (Tenn. App. 1989).

254. *See supra* notes 200-252 and accompanying text.

whom the courts felt were merely negligent or had made an error in judgment were consistently allowed to be exonerated by provisions in the trust instrument or will, whereas fiduciaries who had acted in bad faith, or willfully breached their fiduciary duty, or acted with reckless indifference to the interests of the beneficiaries were not found to be protected by exoneration clauses, no matter how broad or clearly written the clause.

For example, in *Sullivan v. Mosner*,²⁵⁵ the Court of Appeals of Maryland upheld an exoneration clause which protected the trustee in its disbursement of an inter vivos trust fund without proper authorization from the settlor/beneficiary.²⁵⁶ The trust was created to facilitate the purchase and construction of a partially built home bought by the Sullivans.²⁵⁷ William F. Mosner and C. Arthur Eby were the nominated trustees of this trust.²⁵⁸

Mr. Sullivan had hired Frank Vavra, a contractor who had done previous work on the house, to finish the construction on the house, in spite of the recommendation by Mosner that he not do so.²⁵⁹ After the commencement of the construction project, Vavra requested payment, but Mosner pointed out to him that under the terms of the contract Vavra was not to be paid until the job was finished.²⁶⁰ Vavra threatened to walk off the job if he was not paid immediately.²⁶¹ Vavra eventually succeeded in getting trust funds from Mosner.²⁶² At trial, there was some question as to whether Sullivan was notified, but the trial court found that Vavra had called Sullivan who in turn called Mosner and authorized the disbursements.²⁶³ Later in the project, Vavra did not complete his work in the planned amount of time and was fired.²⁶⁴

The Sullivan's brought suit seeking just over \$12,000 in damages and Mosner's removal as trustee.²⁶⁵ They charged Mosner with reckless indifference to their interests as beneficiaries, failure to exercise the ordinary skill required of trustees and mismanagement of

255. 295 A.2d 482 (Md. 1972).

256. *Id.* at 493.

257. *Id.* at 484.

258. *Id.* at 484.

259. *Id.* at 483.

260. *Id.* at 485.

261. *Id.*

262. *Id.* at 486.

263. *Id.*

264. *Id.*

265. *Id.* at 484.

the trust funds which, the Sullivans alleged, Mosner wrongfully disbursed to Vavra.²⁶⁶ Mosner argued that he was not negligent in disbursing trust funds under Mr. Sullivan's direction, and that even if he had made an error in judgment, the exculpatory provision in the trust instrument protected him from liability.²⁶⁷

The trial court did not reach the issue of the exculpatory clause but found that Mosner had not been negligent and that Sullivan's approval of the disbursements of funds allowed Mosner to make the disbursements without fault.²⁶⁸ The court of appeals reversed in part, holding that Mr. Sullivan was not expressly an agent for Mrs. Sullivan and therefore Mosner had not gotten her express approval and had put her interests at risk.²⁶⁹ However, the Court of Appeals found that Mosner had not acted recklessly in assuming that Mr. Sullivan, in approving the disbursements, was speaking both for himself and his wife.²⁷⁰ The Sullivans had argued that the exculpatory provision was completely void as against public policy.²⁷¹

The Court of Appeals instead took the Restatement approach to policing exoneration clauses.²⁷² The court found that Mosner had not profited from the disbursements and had not inserted the clause through an abuse of his relationship with the Sullivans; thus subsection (3) and part of subsection (2) did not apply.²⁷³ The court also found that Mosner had not acted in bad faith, or with reckless indifference to the Sullivans, nor did he willfully breach his fiduciary duty in relying on Mr. Sullivan's approval and disbursing the funds, therefore the exoneration clause was effective in protecting him from liability.²⁷⁴

2. Analysis of Case Law in Jurisdictions Not Citing the Restatement

In some jurisdictions lacking a controlling statute, section 222 of the Restatement is not cited as the proper standard. These jurisdictions, with neither a controlling statute nor a Restatement-based common law approach, have adopted a moderate standard for polic-

266. *Id.* at 486.

267. *See id.* at 493.

268. *See id.* at 490.

269. *Id.* at 490.

270. *Id.* at 493.

271. *Id.* at 490.

272. *Id.*

273. *Id.* at 491; *see* RESTATEMENT (SECOND) OF TRUSTS § 22 (1959).

274. *Sullivan*, at 491.

ing exoneration clauses that is very similar to the Restatement.²⁷⁵

For example, in Michigan, where courts do not cite the Restatement, despite the existence of an exoneration clause, the court will surcharge a trustee found to be guilty of bad faith. In *In re Green Charitable Trust*,²⁷⁶ the Court of Appeals of Michigan affirmed a probate court's surcharge of the trustees of the Green Trusts and their removal from trusteeship for their breach of a duty of loyalty, bad faith, and reckless disregard for the interests of the beneficiaries.²⁷⁷

In September of 1984, Miles Jaffee and Comerica Bank filed their first account for the Green Trusts in the Probate Court, Oakland County.²⁷⁸ St. Peter's Home for Boys and the Michigan Attorney General, as representative for some of the charitable organizations which were nominated as beneficiaries of the Green Trust, objected to the first account, charging Jaffe and Comerica with breach of the duty of loyalty, bad faith, and reckless disregard for the beneficiaries.²⁷⁹ The Green Trusts, a small number of testamentary trusts created by Mr. Green and his wife, contained over \$1,000,000 in cash and securities and an interest in the Green real property called Turtle Lake Farms.²⁸⁰

Soon after Mrs. Green's death, Comerica and Jaffe determined that they would need to sell Turtle Lake Farms in order to satisfy some of the bequests, estate taxes, administrative costs, and the funding of a \$1,000,000 trust fund for the Green's granddaughter.²⁸¹ Turtle Lake Farms spread across 315 acres and consisted of a 211 acre homestead, the Green mansion, one lake, and additional lakefront property.²⁸² In 1983, twenty days after Turtle Lake Farms was put on the market, Comerica accepted an offer from Maurice

275. New Hampshire is one such jurisdiction. In *Reconstruction Finance Corp. v. Faulkner*, 143 A.2d 403 (N.H. 1958), the court followed a moderate standard stating that "exculpatory agreements . . . which relieve a trustee from liability for negligence are valid and enforceable; but such provisions which purport to relieve from bad faith or intentional wrongs are considered to be against public policy and will not be enforced." *Id.* at 408.

Michigan is another jurisdiction which follows a moderate standard similar to the Restatement. See *infra* notes 276-295 and accompanying text.

276. 431 N.W.2d 492 (Mich. App. 1988).

277. *Id.* at 504.

278. *Id.* at 496.

279. *Id.* at 496-97.

280. *Id.* at 494.

281. *Id.*

282. *Id.*

Cohen for \$3,250,000 with a \$1,500,000 down payment.²⁸³ At trial it was shown that the trustees had not gotten a proper appraisal of the property prior to its sale.²⁸⁴ Further, the trustees did not widely advertise Turtle Farms Lake, but circulated some brochures which did not indicate that there should be a quick response.²⁸⁵ Evidence showed that one prospective purchaser was told that he would need an initial outlay of \$4,000,000, and another was originally told that it would be nine months before bids for the property would be accepted.²⁸⁶ Moreover, Jaffee was a member of the law firm that represented the buyer, Maurice Cohen.²⁸⁷ Although the Probate Court did not find that Jaffee had been actively involved with the Cohen side of the purchase, it was proven that he attended some meetings where the purchase had been discussed and he approved of the purchase at those meetings.²⁸⁸

Comerica and Jaffe argued that they were not negligent in their sale of Turtle Lake Farms and that the exoneration clause in the trust instrument protected them even if they had been negligent.²⁸⁹ The trust instrument gave Jaffee and Comerica broad discretion "to do everything they in good faith deem advisable even though it would not be authorized or appropriate for fiduciaries (but for this power) under any statutory or other rule of law. . . ."²⁹⁰

The Probate Court removed Comerica and Jaffe as trustees and surcharged them \$1,900,000, finding Comerica and Jaffe had negligently sold Turtle Lake Farms without trying to obtain a higher purchase price.²⁹¹ Moreover, the Probate Court found that Jaffe had breached his duty of loyalty by aiding his client, Cohen, to obtain the property at an inadequate price, and held Comerica negligent in its response to Jaffe's known conflict of interest.²⁹²

On appeal, Jaffe and Comerica argued that the Probate Court was in error for not giving effect to the exoneration clause.²⁹³ The Michigan Court of Appeals disagreed, stating:

283. *Id.* at 495.

284. *Id.* at 500.

285. *Id.* at 501.

286. *Id.* at 498.

287. *Id.* at 503.

288. *Id.* at 504.

289. *See id.* at 498.

290. *Id.* at 498.

291. *Id.* at 497.

292. *Id.*

293. *Id.* at 499.

The exculpatory clause does not preclude judicial review or application of the required standard of care. . . . [T]ransactions involving self-dealing should be closely scrutinized and looked to see whether the trustee's actions indicated any fraud, bad faith or over-reaching on the part of the trustee.²⁹⁴

The court of appeals found that Comerica and Jaffe had acted in bad faith and prevented the exoneration clause in the trust instrument from taking effect.²⁹⁵ Thus, it is clear that although the court of appeals did not cite the Restatement section 222, the court's conception of the public policy limitations on exoneration clauses appears to be essentially the same as the Restatement's.

VI. CORPORATE FIDUCIARIES HELD TO A HIGHER STANDARD OF CONDUCT

Commentators such as Scott²⁹⁶ and others²⁹⁷ have consistently argued for public policy limits holding corporate fiduciaries to a higher standard of conduct even in the presence of an exoneration clause. States have not, to date, formulated a consistent approach to the question of whether a higher standard should be applied to corporate fiduciary conduct. Instead, state courts appear to have analyzed the culpability of each fiduciary on a case-by-case basis. Often, where corporate fiduciaries have acted with a greater amount of culpability, courts appear to have required a higher standard of conduct from those fiduciaries, although rarely do they explicitly indicate that they are doing so. In contrast, courts have explicitly indicated that they hold an individual fiduciary to a lower standard of conduct, especially if family members are concerned.²⁹⁸ Often, the expressed rationale of the court is the intent of the settlor bolstered by the inherent trust in the family relationship. Rarely will courts identify the presence of an individual fiduciary versus a corporate fiduciary as the most important factor in their decision.²⁹⁹

Good examples of courts giving more leeway to individual fiduciaries can be found in the New York cases giving effect to exonera-

294. *Id.* at 499.

295. *Id.* at 504.

296. See SCOTT, *supra* note 4, § 222.4.

297. For a particularly notable early article advocating the requirement of a higher standard of conduct by corporate fiduciaries, see Shinn, *Exoneration Clauses in Trust Instruments*, 42 YALE L.J. 359 (1933).

298. See discussion *supra* pp. 149-154.

299. For a good example, see *Riggs Nat'l Bank v. Zimmer*, 1977 WL 5316 (Del. Ch. 1977) (mentioning that corporate fiduciaries are held to a higher standard than an individual).

tion clauses in inter vivos trusts³⁰⁰ and in the cases from the Uniform Trusts Act states³⁰¹ discussed above. In *O'Hayer v. De St. Aubin*,³⁰² the New York court even allowed extensive self-dealing in which the trustee, son of the settlor, gained control over a family company by personally purchasing stock out of the trust fund.³⁰³ The rationale of the court was that De St. Aubin, Sr. intended his son to be able to do that.³⁰⁴ In *Bank of Nevada v. Speirs*,³⁰⁵ the Nevada court allowed an ex-husband to personally purchase stock in a piece of property held in trust, of which he was trustee, for his daughter.³⁰⁶ The court placed emphasis on the family relationship and the personal care and concern involved.³⁰⁷

In contrast to the family fiduciary cases, examples can be found of courts rigorously policing the activities of corporate fiduciaries. In *Interfirst Bank Dallas N.A. v. Risser*,³⁰⁸ the Court of Appeals of Texas not only found Interfirst Bank, trustee for the Risser trust, had engaged with in self-dealing and was liable under the applicable Texas statute,³⁰⁹ but the court applied the Restatement standard, much less forgiving of fiduciary misconduct than the Texas liberal statute.³¹⁰ In addition, the punitive damages awarded were very high: \$10,000,000 at the trial level, which the Court of Appeals reduced to over \$2,500,000 on appeal.³¹¹

Two states, Texas and Oklahoma, as mentioned above,³¹² have passed statutes that provide for blanket liability for corporate fiduciaries in the event of self-dealing in spite of an exoneration clause, but allow an exoneration clause to be effective where there is self-dealing by an individual fiduciary. These statutes represent a first step towards an articulated higher standard of conduct for corporate fiduciaries.

300. See *O'Hayer v. De St. Aubin*, 30 A.D.2d 419 (App. Div. 1968); see also *In re Cowles Will*, 255 N.Y.S.2d 160 (App. Div. 1965); *supra* pp. 129-131.

301. See *Bank of Nevada v. Speirs*, 95 Nev. 870, 603 P.2d 1074 (1979); see also, *Newman v. Morris*, 574 P.2d 615 (Okla. 1977); *supra* pp. 131-34.

302. 30 A.D.2d 419, 293 N.Y.S.2d 147 (1968).

303. *Id.* at 424, 293 N.Y.S.2d at 152.

304. *Id.* at 423, 293 N.Y.S.2d at 151.

305. 603 P.2d 1074 (Nev. 1979).

306. *Id.* at 1076.

307. *Id.*

308. 739 S.W.2d 882 (Tex. Civ. App. 1987).

309. *Id.* at 898.

310. *Id.* at 897.

311. *Id.* at 909.

312. See *supra*, note 64.

Thus far, Texas courts have construed their blanket-type statute regarding the corporate fiduciary with mixed results. *Blieden v. Greenspan*³¹³ is an example of a strict reading of section 113.059, maintaining the distinction between corporate and individual fiduciaries. The *Blieden* court cited the Texas statute, section 133.059, and emphasized the language in the statute holding corporate fiduciaries to a higher standard, stating: "Of course, it is clear that no corporate trustee was named by the trustor."³¹⁴ The court also looked to the intent of *Blieden* as a good reason for giving individual fiduciaries room to self-deal, while refusing such room to corporate fiduciaries: "After all, the trustor-settlor had appointed his own brother, William, as well as his wife, Doris, to be trustees and he obviously wanted to give them the fullest protection that the law allowed."³¹⁵

Where the fiduciary's conduct was culpable enough, however, another Texas court did not find the distinction between corporate and individual fiduciaries to be controlling. In *Langford v. Shamburger*,³¹⁶ the court held that Shamburger had committed all of the claimed breaches of trust and he should be deemed liable despite the exoneration clause, Shamburger's family relationship with Langford, and the Texas statute not regulating self-dealing by individual fiduciaries.³¹⁷ Apparently, the culpability of Shamburger was simply too great.

The benefit of a statute like Texas' is that it encourages courts to apply a higher standard against the conduct of a corporate fiduciary. The problem that may occur from the blanket statutory restriction on self-dealing is that a court may lose the flexibility of equitably deciding the case based upon the special set of facts presented. For example, corporate fiduciaries who include exoneration clauses in instruments without the knowledge of the creator would not be prohibited from doing so by a statute which provided a higher stan-

313. 742 S.W.2d 93 (Tex. Civ. App. 1987), *rev'd*, 751 S.W.2d 858 (Tex. 1988). The settlor of the trusts had named his brother, his wife, and Greenspan as co-trustees. The trial court found that Greenspan had not accepted a position as individual trustee for the trust created by *Blieden*, but if Greenspan had accepted the trustee position, he would have been protected from a claim of self-dealing by the exoneration clause. 742 S.W.2d at 94; *see supra* notes 145-46 and accompanying text for a full discussion of the case.

314. *Id.* at 96.

315. *Id.* at 97.

316. 417 S.W.2d 438 (Tex. Civ. App. 1968). P.P. Langford sued C.D. Shamburger as trustee of the Langford trust for failure to invest the trust corpus, for borrowing money from the trust fund, and for commingling the trust fund with Shamburger's own assets. Shamburger was Langford's uncle. For a complete description of the case, *see supra* pp. 142-43.

317. *See id.* at 440, 444.

dard of conduct for corporate fiduciaries but which was restricted to self-dealing. A middle ground to be considered in the future would be a statutory rule that requires the adoption of a higher standard in policing the activities of a corporate fiduciary, but does not restrict that higher standard solely to self-dealing by a corporate fiduciary, thus leaving flexibility with the courts to deal with the unique set of facts presented.

VII. COMMON THREADS THAT CAN BE WOVEN TOGETHER TO CREATE NATIONAL UNIFORMITY

What we have seen above demonstrates that, while it appears on the surface that there is great diversity among states regarding the propriety and the effectiveness of exoneration clauses, in fact, on closer examination, the decisions of the courts are actually closely aligned. New York, by statute, strictly regulates the use of exoneration clauses in wills, but the New York courts interpret that statute as excluding inter vivos trusts, thus narrowing the restrictive effect of the statute and allowing an entire group of instruments to be drafted with effective exoneration clauses. New York is the prime example of a jurisdiction in which there are conflicting policy judgments being made by the legislature and the judicial system.³¹⁸

Texas has enacted and reaffirmed a statute liberally allowing exoneration clauses.³¹⁹ Yet, Texas courts have cited the Restatement moderate position in more than one recent case, demonstrating, like New York, an internal inconsistency in their overall approach, but, also like New York, showing a tendency towards a moderation of their somewhat extreme statutory approach.³²⁰ Taken together with the general recent trend of states adopting moderate statutes, it appears that most jurisdictions, even the most extreme, are moving towards a less diverse, more moderate, nationally consistent approach.

Based upon a close examination of the caselaw, the author concludes that if fiduciaries act with culpability beyond mere negligence, regardless of an underlying statute, state courts will attempt to find a way to limit the effectiveness of exoneration clauses, sometimes despite the plain language of an applicable, inflexible statute.³²¹ If fiduciaries are merely negligent or have made mistakes in

318. See *supra* pp. 126-131.

319. See *supra* notes 116-120 and accompanying text.

320. See *supra* p. 144-45.

321. The Texas courts are the best example of this tension between a rigid statute and a court's desire to rule equitably. See *supra* p. 145.

judgment, state courts will give effect to an exoneration clause. Courts are likely to be particularly concerned if the exoneration clause gets drafted into the will or trust instrument through an abuse of a fiduciary relationship; a clause may not be given effect based on those grounds.³²² Where state statutes are at inflexible extremes, state courts must strain to effectuate an equitable result. The present diversity of statutes only contributes to the difficulty in allowing the courts to reach fair results.

It would seem appropriate for the National Conference of Commissioners on Uniform State Laws to consider the topic of exoneration clauses and to promulgate a uniform statute for adoption in all states. In drafting a uniform rule, the Restatement section 222 might be the best resource with which to begin. The moderate position set out in the Restatement provides enough flexibility for courts to analyze the facts of each case and give effect to an exoneration clause when it appears as though the fiduciary was not extremely culpable and when, on balance, it is more appropriate to follow the intent of the settlor than the strict rules of fiduciary administration. Special factors to be dealt with in the drafting of a new uniform statute include the need for safeguards to be sure that the creator of the instrument is aware of the inclusion and the effect of an exculpatory clause, and the need to consider a higher standard of due care for corporate fiduciaries.

One improvement in the design of a proposed uniform statute would be an expanded comments section which could contain sample forms that would help to guide a draftsman in clarifying the intent of the creator of the document. For example, a form could be included to show how to clarify that there was a specific request for the use of an exoneration clause, or, at the very least, that the creator knew of its existence and did not object to its inclusion. The sample form could provide a place for the settlor's signature, either on a separate sheet or within the instrument beside the exoneration clause. Alternatively, it could be required that an exoneration clause include a sentence stating that the draftsman has notified the creator of the instrument regarding the presence of the clause and that the creator understands its impact and desires its inclusion.

The creation and widespread adoption of a new statute to regulate the use of exoneration clauses can have a most helpful effect on

322. See, e.g., *Estate of Lubin*, 143 Misc. 2d 121, 539 N.Y.S.2d 695 (Sup. Ct. 1989).

the fair administration of wills, trusts, and other documents in which an exoneration clause might be included.